RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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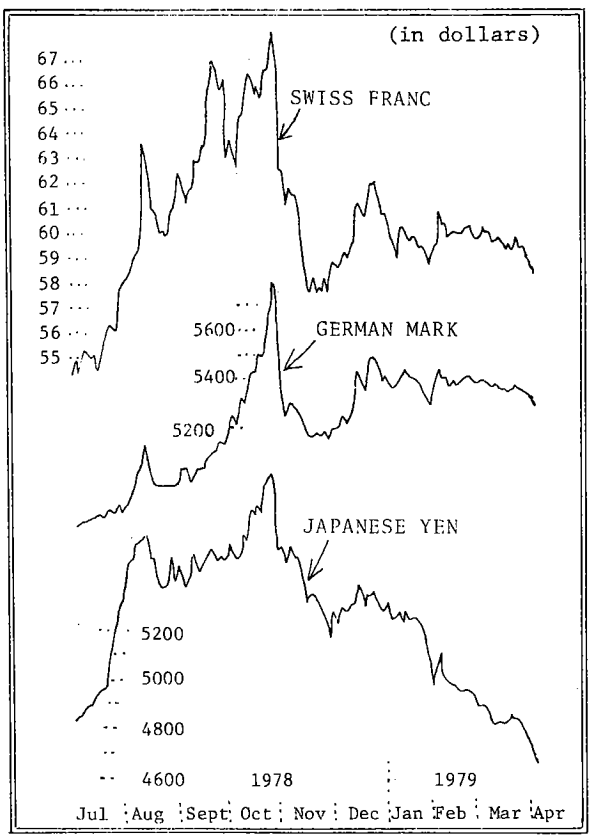
April 11, 1979 **LETTER 754**

Mar. 30, DJIA 862.18; PTI 957; A-D Ratio –18.77
Apr. 6, DJIA 875.69; PTI 979; A-D Ratio –18.26

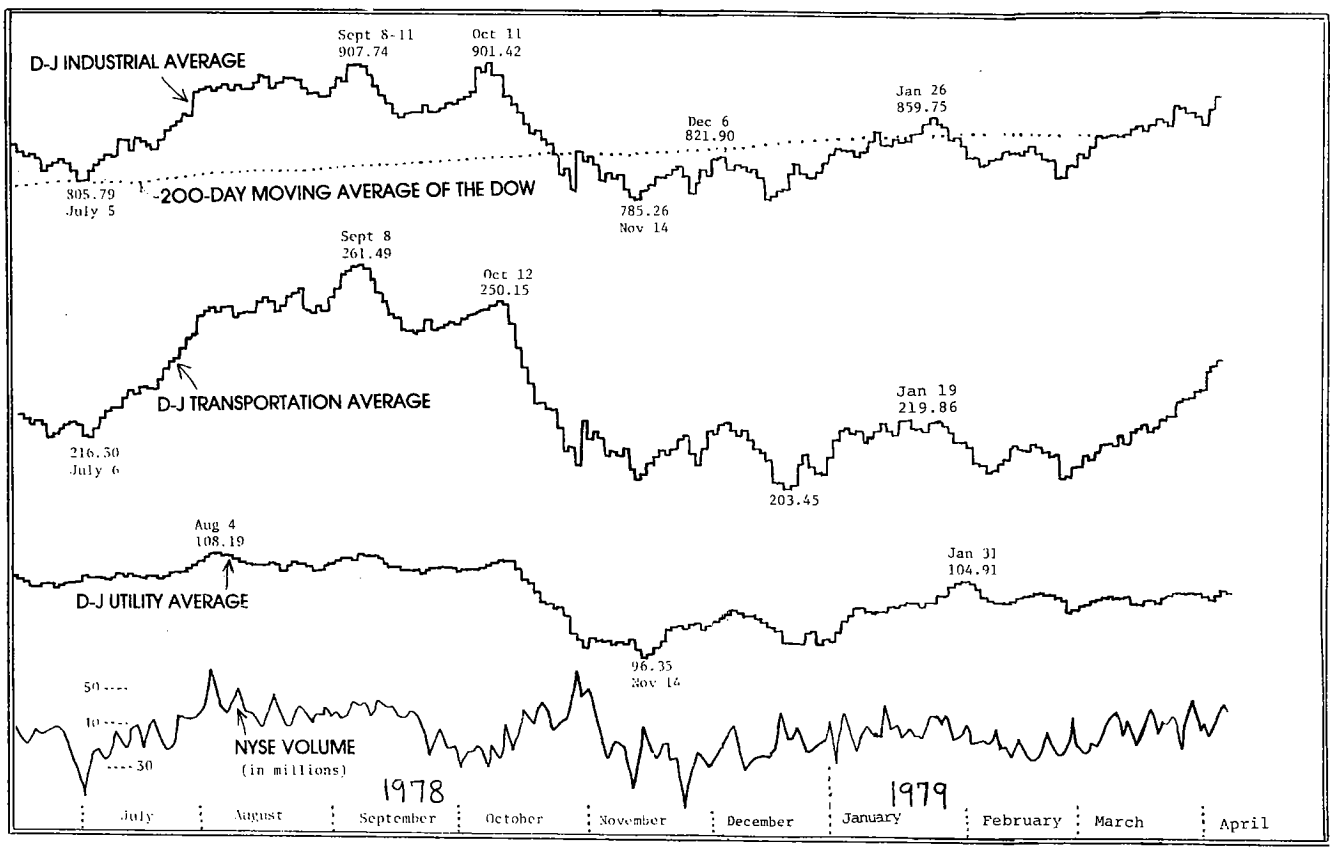
RETROSPECTION: The great tidal changes are seldom recognized at the time. Who, in 1929, knew that an entire, fabulous era had ended? Who, in 1932, knew that the stock market was making a low that would perhaps never be seen again? Which of us, in 1942, realized that the tide of war was turning in favor of the Allies and that the Dow (at 92.92) was a fabulous bargain (which of us in 1942 even thought about the stock market?). And which of us in 1949 knew that a great bull market was starting–or that 30 years of unceasing inflation lay ahead?

Now in 1979, who knows what it means that the Dow topped out in 1973, that the D-J Transports topped in 1969, that the D-J Utilities topped out in 1965? And which of us can know what it means that booming profits, rampant inflation and ballooning money supplies have all failed to take any of the major Averages above their previous highs? What can the markets know that is not yet known by us? I wonder . . . .



THE PICTURE: Towards the end of October of last year the dollar went into an almost unprecedented tailspin. Gold soared to a record high, the stock market panicked, the pundits announced that the dollar was "finished," and the Carter Administration got its first lesson in international money management.

I took issue with the prevailing opinion. In Letter 744 (Nov. 22, 1978) I stated that at least for a while "the dollar is going to be King." In that Letter I showed a chart of the trade-weighted dollar, and I drew attention to the fact that the dollar had crashed in a series of five downward legs. According to my "Elliott count" the dollar decline (in November) was exhausted. On that basis, I said that the giant short position against the dollar was in for a fierce squeeze, and I was also of the opinion that gold would be adversely affected by these



developments. In the next Letter (745) I presented a chart showing that the US import/export picture was changing for the better, and this too was to have a bullish effect on the dollar.

Examine the chart (page 1) of the three major non-dollar currencies. It's telling a dramatic story. The Swiss franc and the German mark are moving sideways following their October-November smash, while the Japanese yen has collapsed (I had previously recommended shorting the yen). All this is giving the US "breathing time."

The fact is that Federal debt in the US is climbing at the rate of perhaps $1 billion a week or more. The giant US inflation machine is taking on a life of its own, and it's growing like a monstrous monetary cancer. Furthermore, there is no one in the world, no nation, no Central Bank, no Treasury with the power or the will to stop it. A friend called me last week and asked which way I thought the US financial and monetary winds were going to blow. I answered, "The way that will produce THE LEAST PAIN." And that way is the continuous path of inflation. As I see it, all the mouthings against inflation are just that and no more–simply mouthings. No one really wants to halt inflation. No one wants to deal with the pain and hardships that will be brought on by deflation.

So what's happening? Simple: the world is trying frantically to position itself to "go with the flow," to keep up with or to benefit from inflation. The rich are buying collectibles, homes, land, farms, art. The poor are going on strike for higher wages. The middle class is being wiped out, even as they push for more Proposition 13-type laws. The Arabs are cutting back on oil shipments while raising oil prices. The undeveloped countries are (if they possess natural resources) trying to form OPEC-type cartels to boost the prices of their products. The poorer nations are screaming, "give us money or we'll go Communist." And the inflation beat goes on.

I've said this before but let me repeat it. Nobody beats inflation in the end. You either stop inflation, kill it, take the pain of correction, or you are destroyed by it. You may think you're beating inflation by owning two houses or a big farm or a juicy collection of rare US stamps or 50 pounds of gold–but you're only kidding yourself. Ultimately, when the Government runs into extreme trouble, the jaws of the vice are going to be closed.

What could happen? We could have price and wage controls–and profit controls. We could have exchange controls, or we could have restrictions on trading gold (own it but don't sell it). We could have an internal (still inflating) dollar and an external dollar (acceptable to foreigners). Or we could have rationing all around on some supposedly "fair" basis dreamed up by Jimmy Carter. Or we could have Big Government telling us how much we can spend and taxing the hell out of everything that we don't spend.

So what are the operative concepts that we must live with today? There are two of them that I see: (1) Figure out what course will avoid pain or produce the least amount of pain, and that's the way our Government will go and that's the way the people will vote. (2) Count on it, the Government will do anything it has to, ANYTHING, in order to perpetuate itself. That anything can include confiscation of wealth, taxing of income, curbing of rights, even abridgement of liberty if need be.

* *

The strength in the dollar has brought on a number of phenomena. First, it has made the holding of the so-called hard currencies less attractive. So we see German and Swiss and Japanese money flooding into the US. This money is buying land and houses and companies (not the stocks, but the companies). Second, we see a breather for interest rates. With no pressure on the dollar, the pressure has also eased on interest rates. Third, the unexpected ease in interest rates has brought money into the stock market. And it has tended to extend the economic expansion. So the implications of the great new dollar strength have been momentous.

One of the biggest problems overhanging the nation today is the squeeze on cash flow. Inflation has driven everyone and every corporation into things and inventory, and there's just no real liquidity around. Ordinarily, sky-rocketing interest rates would have put the "finishing touches" on this situation and brought the economy to its knees. But the strong dollar has taken the pressure off interest rates and sustained the boom for a while longer (perhaps to late 1979 or even early 1980).

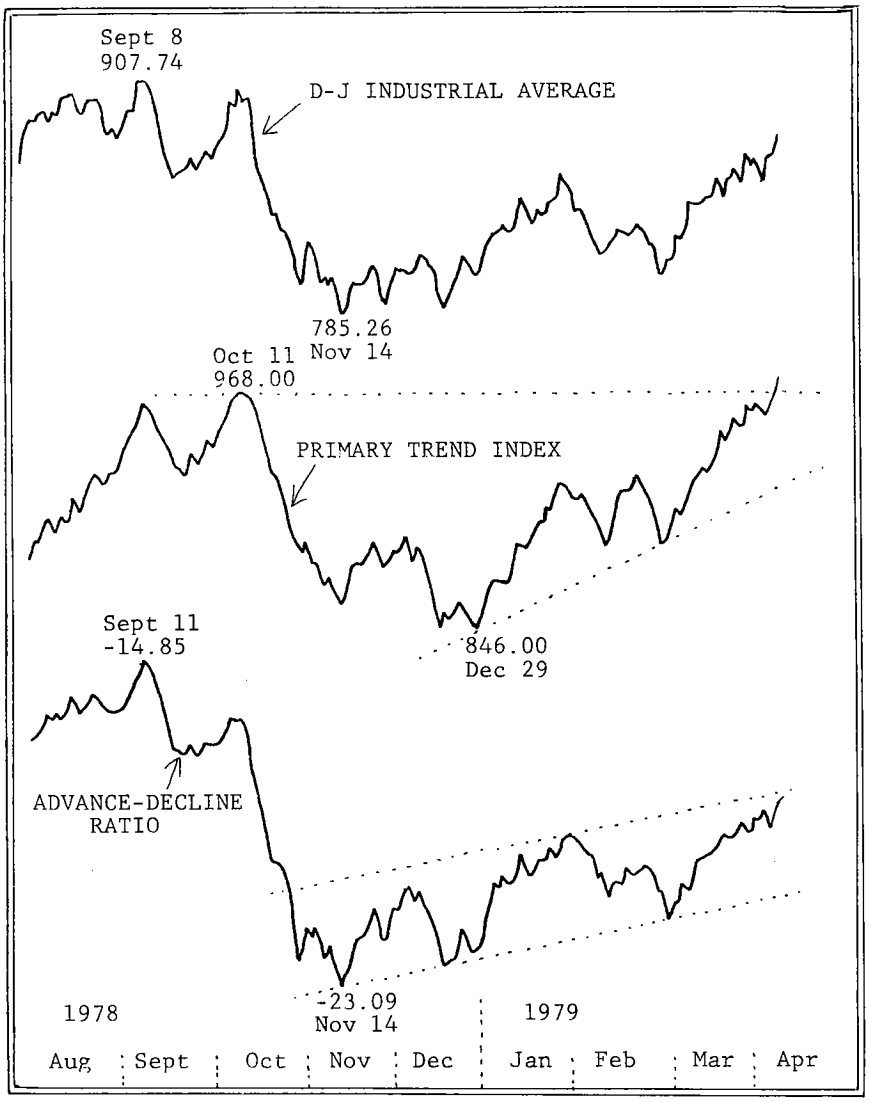
Now there's another phenomenon that has come out of the strength in the dollar. The strange and exotic fact is that the man who had switched to dollars (say in the form of 91-day T-bills) around the end of October, 1978 would be AHEAD of the game. Of course, I know that there are many people who were smart enough to put half of their assets into Bally or Dome Petroleum or cattle futures, but for the average guy or gal the T-bills have been a good haven.

I must have the world's (1) most sophisticated, (2) most intelligent, or (3) wealthiest subscribers, because I never feel, as most investment advisors do, that I must put in a "list of stocks to buy" in each and every issue of these reports. I have a secret pact with myself, and the pact runs this way: "Richard Russell never suggests that his subscribers take a position in anything that he isn't willing to take a position in himself."

One of the things I do is insist that each of my subscribers act as if he had a lot of money to handle. I don't care whether you have $10 thousand or $10 million, that represents all your liquid assets, and as such it deserves respect. I happen to look at all markets in terms of risk and reward, and I feel no pressure to recommend "stocks to buy" year in and year out. In handling my own money, I like to limit the downside risks as much as possible, and that means putting money in the markets ONLY when the green lights are flashing and the technical sirens are singing.

Standing on the sidelines used to be tough, but I don't find it tough at all when T-bills are yielding over 9.5% and the other markets are over-bought, choppy and nervous. Furthermore, I don't need anything besides my intuition to tell me that 9-10% interest on safe debt instruments is vicious competition for stocks.

Conclusion: With current dollar strength taking the pressure off any move to higher interest rates, the Fed and the Administration have decided to take a chance and let inflation and the economy run. It's too late for Carter to risk a recession and then a dramatic Government-inspired pullout prior to the election. Carter now has to "go for it," let the economy have its head and hope that things somehow hold together between now and election time. The market senses this, and it is hedging itself against more inflation by moving higher. But this is a speculative and belated move and one that does not attract me personally. I don't have to "play 'em all."



THE MARKET: Over the past few weeks both Averages, the D-J Industrials and Transports, have bettered their preceding peaks (Industrials above 859.75, Transports above 219.86 as seen on the page 1 chart). Under Dow Theory this constitutes a bullish signal. But in answer to many inquiries I do not see it as a primary bull signal, since it has come very late in the game.

The rise does turn the secondary trend bullish, however, and the Averages are now in line for a testing of the October highs of 901.42 (Industrials) and 250.15 (Transports.) I am personally dubious about the ability of the Averages to better the late-1978 highs, and you can see as you study the page 1 chart that the two Averages have actually been in a trading range for many, many months. With the present over-bought condition of the market, it seems to me that the odds favor continued frustrating fluctuations within the long trading range.

Based on the time span of the rise since 1974, based on the monetary conditions now prevailing, I would personally guess that the ultimate resolution of the trading range will be to the downside. At any rate, that is the way I am playing it myself.

* *

The Primary Trend Index (PTI) is my own unique tool. It is an amalgam of eight important averages and indices, including the three D-J stock Averages, the S&P 500, the D-J Bond Average, the A-D Ratio, the high-low index and the most-active stocks index. Now you can fool one or two of these technical items, but you can't fool all eight of them, and that's what the PTI is all about. It's a technical spectrum of the stock market.

A steady and persistent rise in the PTI acts very much like a "rising floor" under the market, ultimately forcing it higher (obviously, a steadily declining PTI would exert the opposite effect). So much for the explanation.

From its October high of 968 (see chart), the PTI slid to a low of 846 on December 29, 1978. Since then, despite all sorts of hesitancies and false starts in the Averages and in other indices, the PTI has been outstandingly strong. On April 3 the PTI rose to 969, above its October 11 peak–to a new high since 1974.

This represents the second instance of a new kind of action for the PTI. Back in October, the PTI began outperforming the Dow, and on October 11 the PTI recorded a new high, a high unconfirmed by the Dow. This non-confirmation set off the smash known as "the October massacre." In eight years of watching the daily action of the Dow and the PTI I had not seen the PTI act this much *stronger* than the Dow, and I was therefore most interested when price (the Dow) would not confirm the technical syndrome (the PTI).

Now again, in even more dramatic form, the PTI has pushed to a new high with the Dow failing by almost 30 points to confirm. From here on strength in the PTI will provide the clues. If the PTI can continue on its stubborn path upwards, it will drag the Dow and everything else up with it. But in view of the current non-confirmation, I would view any persistent weakness in the PTI as a very bearish omen. For it was the sudden weakness in the PTI following the October 11 non-confirmation that signalled the two month smash which was to follow.

Adding to the drama of the situation is the profile of the advance-decline ratio. As you can see, the A-D has been moving up within a shallow rising channel. Most recently the A-D has pushed to a high for 1979. But the high is not an impressive one, being better than 4 points below the peak recorded on September 11, 1978.

Thus we have a situation today where the Dow is lagging the PTI and the A-D is lagging the Dow. I've never seen anything quite like it, and the resolution ought to be quite fascinating. But the key will be seen in forthcoming strength or weakness in the PTI. By the next mailing I should be able to present some important observations in this area.

One disturbing item in the present market is the dearth of new highs (52-week basis) on the NYSE. Last August, with the Dow in the 860-870 range, my 5-day average of new highs touched a peak of 240. On April 5 (last week) with the Dow in the same area the 5-day average of new highs recorded a 1979 peak (yes, a peak!) of 66. That's hardly impressive action. It means that a lot of stocks have refused to participate in this rally. To my mind, the rally of 1979 is (so far) on dubious grounds.

AS 1979 MOVES ALONG: I've been making mental lists of the positive and negative factors which may be affecting stocks and the economy at this time. I will list a few of them

below. **Positive** factors:
(1) Everyone is talking about recession in 1979 or '80. Thus the market has bullishly absorbed a great deal of pessimism.
(2) Institutions, funds and pension funds are holding huge amounts of cash on the sidelines.
(3) The dollar is strong. The US trade balance is improving.
(4) The stock market is conservatively priced on an historical basis.
(5) The Dow is currently very close to its 13-year or super-long term moving average. Thus, it is selling close to a long-term average price or near *equilibrium.*
(6) Interest rates in the US seem to be stabilizing or even easing.

Bearish factors:
(1) The economic expansion is now going into its fifth year. It is over-extending. The same can be said for the stock market advance which started in October-November, 1974.
(2) Presently, there is an inversion in interest rates with short-term rates holding ABOVE long-term rates.
(3) The D-J Averages are still far below their 1978 highs, and time would seem to be running out on the economic "boom."
(4) The latest rally has brought in a very low level of daily new highs on the NYSE. The advance-decline ratio has lagged the Dow, and the broad NYSE Index is now lagging the Dow.
(5) Inflation in the US is running at a rate of almost 15%.

And the puzzling factors: commodities look rotten. Cattle toppy, hogs collapsed, cotton crashed, lumber and plywood toppy, the bean complex and wheat questionable, the precious metals toppy and weak, copper still hanging on but could be topping. What does it all mean? Is this just a big correction? Is inflation ebbing? Meanwhile, the yen is collapsing against the dollar and the British pound is climbing against the dollar. Interest rates (short term) are firm, but I want to see more here. On a cold and emotionless appraisal, the commodities could be discounting a forthcoming weakening in the economy. If so, we should see signs of it in the economy within three to six months. Then there's the stock market to ponder.

I spent all last weekend mulling over these various pros and cons, and I came up with a strange thought: wouldn't it be characteristic if the Dow and the market were simply to lapse into a broad trading range over the next year or even longer? And wouldn't it be typical of the market to produce the most frustrating scenario possible?

About a year ago I wrote a good deal to the effect that "market timing" was being done to death. I noted that the market has its own way of foiling the majority and its own way of driving the analysts "up the wall." Now the perfect way to cross up an army of market timers is to produce a frustrating, trading range type of market. And that's exactly what we've had ever since mid-1976!

Personally, I believe there's a good chance that the trading range market will continue for a while. I sensed it was coming many months ago, and that's the reason I advised (1) Treasury bills, and (2) a limited amount of gold. My experience has been that the average investor does far better with a safe, high-yielding investment during a trading range market than he does trying to catch the rapid, usually deceptive swings. In trading range markets investors tend to enter during the middle to upper thirds of the rises and sell during the middle to bottom thirds. Both procedures are invariably costly.

It's interesting to note what has happened in the trading range markets which began in mid-1976. The public has been *leaving Wall Street* and moving into money instruments, houses, and collectibles. The public (and most traders) simply does not make money during trading ranges. If you trade three or four swings and lose 5% to 10% on each swing, you're talking about losing a quarter or more of your assets. So the public has been "nickeled and dimed" to death in the trading markets since mid-1976. And they've finally left the Street to the institutions. Which is where we are today.

Question: Russell, how does all this affect your scenario of a market top of some kind in early May, 1979, and an important low in July?

Answer: The market has been buffeted by every kind of negative news from the oil price boosts to the Iranian mess to last week's "spill" in a nuclear power plant. Therefore, one must concede that today's stock prices have discounted a great amount of bearishness. Nevertheless, I continue to expect some kind of a shocker to hit during late-April or May. This could have the effect of knocking the market down to a panic low in July. BUT because of the huge amount of bearishness that has already been absorbed by the market, I would not expect the Dow to drop much below the 700 to 750 range. In that area, the market should be oversold to the extreme and most interesting from a buying standpoint.

NOTES & QUOTES: There is another cost for the US that has grown out of our energy non-policy. And that cost is the wondrous "Carter Peace Policy." This headline from the March 18 NY Times says it all, but I would imagine that the final costs will be more than twice the $5 billion listed.

In case you're wondering, it isn't our love for Democratic Israel that has prompted Uncle Sam's fascination with peace in the Mid-East. What has brought on the US peace offensive is the fact that we're vitally dependent on Arab oil, and an Egyptian-Israeli alliance is a plus for US oil chances in the Mid-East–but a slim plus at that.

U.S. WILL GIVE EGYPT $2 BILLION IN ARMS; $3 BILLION TO ISRAEL

SIGNING EXPECTED ON MONDAY

Cabinet in Jerusalem Backs Treaty by 15 to 2 Vote — Brzezinski Ends Mission in Mideast

By BERNARD WEINRAUB
Special to The New York Times

WASHINGTON, March 19 — The United States pledged today that after the

With it all here's a long standing Russell prediction: the age of the 180 lb. American riding to the corner drug store in a 3500 lb. machine is fast coming to an end. I don't know whether the day of the moped or the 1500 lb. car is coming, but the situation is going to change. I'm absolutely certain of it.

* *

For about the first time in US history, consumers have lowered their savings inclinations in the face of rising inflation. In the last quarter of 1978, personal savings dropped to 4.8%, one of the lowest quarters on record. Previously, when inflation had heated up the savings rate had climbed. Conclusion: today's consumer has decided to borrow as much and as fast as he can during a

period of high inflation. It seems as if the consumer is finally copying the lead of his Government.

* *

If there's a shocker coming up, my instinct says it could well be trouble in Saudi Arabia. The Saudis are over a barrel. If they become too Anti-Egypt, they move towards the "Islam Republic" concept, and that would spell the end for the sheiks. If they become pro-Egypt they risk revolution via the PLO. Saudi Arabia has over $100 million in oil revenue coming in daily, and this makes the juiciest plumb in the Arab world. I thought this piece from a recent New York Times Magazine article was so fascinating that I wanted to use an excerpt:

The amalgam known as Saudi Arabia yields the most improbable outcome: A theocratic monarchy is ruling and orchestrating — so far successfully — the sweeping transformation under a system with no constitution, no elections and no opposition, yet with the support of the people.

It yields the greatest of incongruities: Cadillacs dodge herds of goats on main city streets; 32-flavor ice-cream shops and newsstands sell Mad magazine and close for prayers; Yemenis drive donkey carts past avant-garde sculptures; adulterers are beheaded in the shadow of skyscrapers; airports connect cities not linked by paved roads; the rich, usually Saudis, discard cars like gum wrappers, leaving them on the road when they break down, while the poor, usually foreign laborers, grovel in shantytowns.

* *

Personal notes: about eight months ago I cut red meat out of my diet (I now eat chicken and fish instead). About four months ago I cut out all sugars and oils, which means that I eat vegetables of all kinds, fruits of all kinds, beans, chicken and fish, plus pita bread (flat Arabic bread made of whole wheat and water and salt), corn tacos and wheat sprouted bread and any crackers made without sugar or oil). I've lost 12 pounds and feel better. I am convinced that "low to no red meat" is the wave of the future (yeah, then why are cattle futures near record highs!).

* *

When I was a young man, any kind of psychological help was hard to come by and usually expensive, and if you did anything along those lines you did it in utmost secret. Now help is available everywhere, it seems to be taken for granted (like welfare or social security). I think some of the self-help books being published these days are excellent. And with a crazy world and a neurotic citizenry, these books are certainly needed. Two which I have just read and which I recommend are (1) "Taking Chances, the Psychology of Losing and How to Profit From It" by Dr. Robert Lewis (Houghton Miflin, $7.95) and (2) "I Want to Change, But I Don't Know How" written by two San Diego MD's, Tom Rusk and Randy Read (Blue Pacific Books in paperback, $5.95). If you're embarrassed at the idea of anyone knowing that you need help, forget it. Everyone needs help, except the angels. And I haven't met more than one or two angels in the past 54 years.

* *

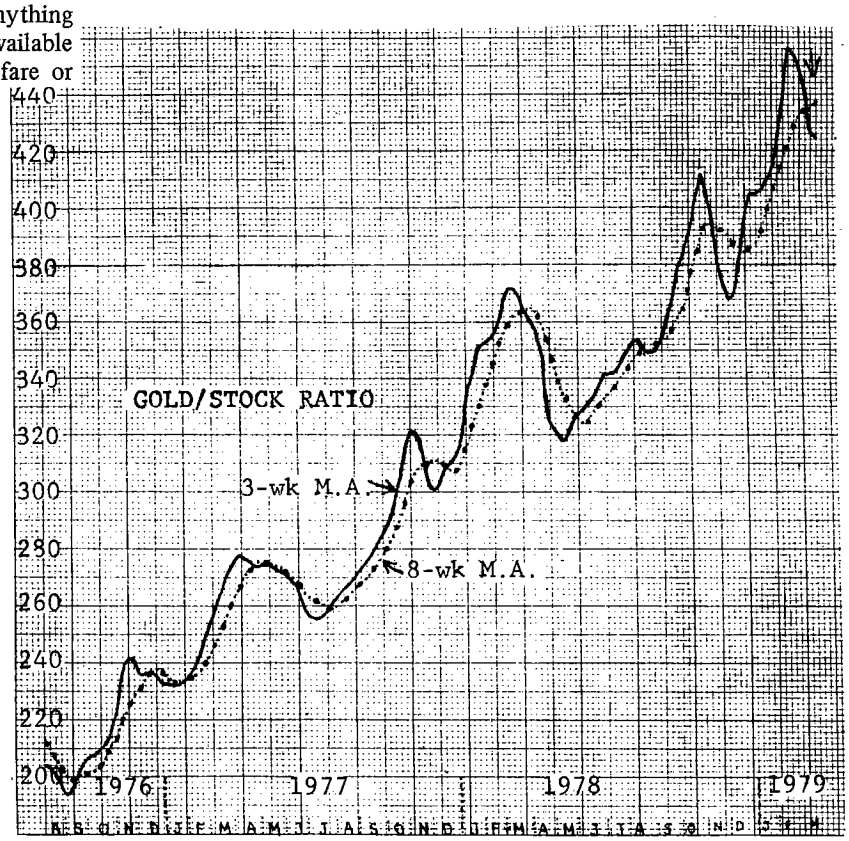
Last week 535 administrators of public pension funds met in San Diego. These men handle a large part of the 500 billion of the nation's public pension assets. Here's an interesting excerpt from San Diego Union's Financial Editor, Don Bauder's coverage of this San Diego conference.

> A major theme of the conference was whether or not the nation can afford the public retirement programs. The administrators frankly question whether politicians, under pressure because of the public's cost-cutting and tax-cutting mood, will continue to honor benefit obligations. And the administrators fear that the federal government, which has totally mismanaged its own programs, will pass legislation to regulate the public employee funds — and worse, try to grab the monies to bolster the flagging Social Security system.

GOLD VS. COMMON STOCKS: I run a weekly ratio of gold divided by the NYSE Composite Index (the latter being an index of all NYSE common stocks). In order to smooth out the ratio, I run it on a 3-week moving average basis and an 8-week MA basis. Anytime the 3-week MA is rising, it is telling us that the relative strength of common stocks is superior to gold. The converse is true when the 3-week MA is falling. To prevent whipsaws, I use signals which are given whenever the 3-week MA rallies above, or drops below, the 8-week MA.

The solid line on the chart represents the 3-week MA of the ratio. The dotted line is the 8-week MA of the ratio. On a long-term basis, it is immediately apparent that gold has been performing better than common stocks ever since August, 1976. Since August, 1976 there have been numerous signals given by the crossing and re-crossing of these two MA's, but the broad trend has been up for the ratios–in favor of gold.

This rising trend for gold relative strength has lasted for 2½ years, which is a long time for a relative strength trend. How much longer the bullish long-term gold relative trend can last, I don't know. A week ago the 3-week MA of the ratio dropped below the 8-week MA, giving a relative strength signal in favor of common stocks and against gold.



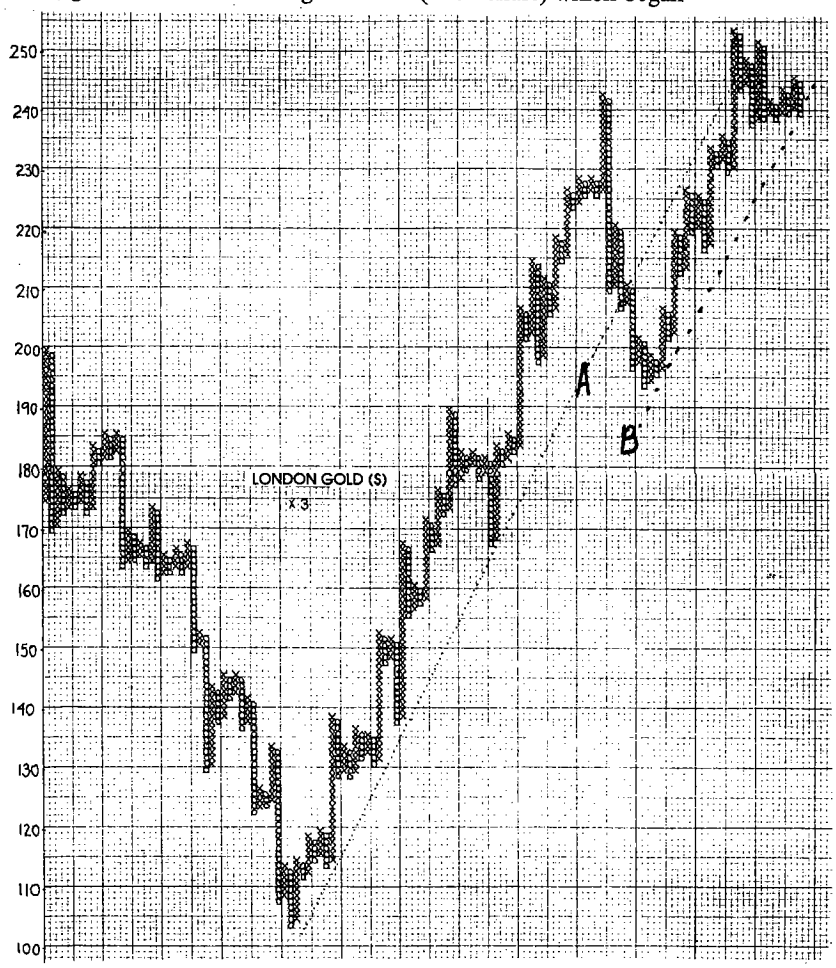
If you take a ruler and connect the bottoms of September, 1976, July, 1977, and May, 1978, you will see the major rising trendline for RS in favor of gold. The ratio would have to break 396 in order to shatter this trendline. If that happened, I would take it as very bullish for common stocks compared with gold.

GOLD: Over the last six months we have seen a tremendous advertising and distribution compaign for gold. Full page ads in newspapers, radio comments and daily quotes, centerfolds in magazines, plus a tremendous push on the part of the jewelry industry–all bent on selling gold to the public. The result, I feel, has been to place gold in weak hands.

During all this hoop-la, the price of gold never rose substantially above its 1978 high of 243. And this means that in the face of the compaign and the heavy buying by the public, all the needed gold was readily supplied. My current feeling is that gold is going to need a rather lengthy period of reconsolidation and correcting; gold is going to have to wear out the weak speculators and move back into the rock-strong hands of the hard-money crowd, the true believers.

Thus, it would not surprise me to see an extended period (maybe three to nine months) in which gold backed and filled within a trading range of say 225 to 245. Or it would not surprise me to see gold break down and perhaps test the 200 to 210 level again.

I include here my 1 x 3 point and figure chart of London gold, a chart that shows every rally or decline of 3 points or more (each box on the chart equals one point). During last year's violent break, gold shattered the long trendline (A on chart) which began from the 103.50 low of 1976. Many analysts pooh-poohed the break, saying that it was a simple shaking out of the margin account in the futures market. I did not agree. I have seldom seen a violent decline (a decline that ruptured a major trendline) that was not later seen to be a significant turn. Despite the subsequent rise to a new high in 1979, I continue to see the correction since late-1978 as an important one.



You can see on the chart that gold is now testing trendline B, a trendline that starts from the late-1978 low and runs parallel to Trendline A. At a London spot price of 237, trendline B will have been violated. If that happens, I would think that the recent distribution phase for gold is over and that the 220-225 area will be tested.

I have been asked what my "ideal scenario" for gold would be. Well, from my own selfish standpoint and that of my subscribers, I would like to see gold break below point B (below 193) at which point I would be willing to assume a fairly large gold position again. Could that happen? Sure it could, particularly if the dollar remains strong for a period of perhaps six months or longer. My feeling now is that there is a 50/50 chance that gold will test the 200 to 215 level and a 1 in 3 chance that gold will break below point B. Not bad odds, but I continue to suggest "insurance positions" in gold which means positions of up to 10% of total liquid assets.

U.S. FINANCES

WASHINGTON (AP) — Here are the figures on government spending and debt (last six digits are omitted) as of April 4:

Total public debt	797,284
Interest on public debt for Feb.	4,320
Interest for fiscal year through Feb.	24,537
Budget deficit for Feb.	5,100
Budget deficit for Feb. last year	6,991
Budget deficit fiscal year so far	31,599
Estimated deficit fiscal 1979	33,175
Outlays fiscal year so far	202,052
Outlays same period year before	184,138
Gold for Jan.	11,592

LATE NOTES: Here's the very latest run-down on the US Federal debt. A few more weeks and the debt is going to hit the $800 billion mark. Next stop–"the magic trillion"!

If that bothers you, here's a quote from the great Danish philosopher, Kierkegard. His formula–"walk away from it." I think he definitely had something there.

> ***"Above all, do not lose your desire to walk; every day I walk myself into a state of well-being and walk away from every illness; I have walked myself into my best thoughts, and I know of no thought so burdensome that one cannot walk away from it."***

All the bulls are putting the next stop for the Dow at 950. Maybe so, but I'd be careful. When everyone is looking at one level, the market has a nasty habit of not quite obliging.

NEXT LETTER: April 25th